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CENTRAL INTELLIGENCE AGENCY  
WASHINGTON, D.C. 20505

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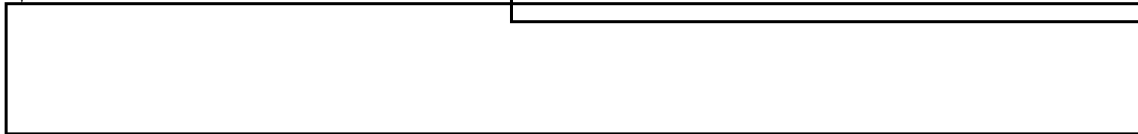
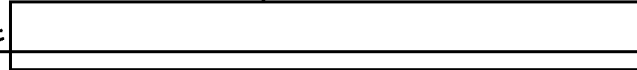
27 February 1974

MEMORANDUM FOR: Dr. Eric Forman  
Office of Policy and Planning  
Maritime Administration  
Department of Commerce

SUBJECT: Transmittal of Material on the  
Reopening of the Suez Canal

In response to your request for material on the outlook  
for a reopened Suez Canal, we are sending the latest analysis  
by our office on this topic. If you wish any further informa-  
tion, please contact

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Chief,  
International Transportation Branch  
Office of Economic Research

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Attachment:  
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ECONOMIC CONSEQUENCES OF A REOPENED SUEZ CANAL

World Shipping

1. Although the Suez Canal almost certainly will never regain the importance it had prior to June 1967, it will still be a major shipping route. Its reopening will reduce the number of ships needed to carry world trade, at least temporarily depressing world shipping rates and slowing shipbuilding orders. The effects of reopening are likely to be overshadowed, however, by more important factors. Even with the Canal closed, demand for shipping services is expected to slacken during the next year or so because of a slowdown in growth of world trade and output. Demand for tankers already has dropped in response to Arab oil cutbacks and price hikes, and excess capacity will increase in the months ahead as deliveries of previously ordered ships accelerate. The reopening of Suez will compound the excess capacity problem

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and further cut into shipowners' profit margins. The net effect will be to transfer income from shipowners to consumers and producers.

2. Restoration of the Suez Canal to its pre-closure draft limit of 38 feet will permit transits by fully loaded tankers and dry cargo ships to up to 50,000 deadweight tons (DWT) and transits without cargo (in ballast) by ships up to 150,000 DWT. Given the current composition and employment of the world tanker fleet, only about 65 million tons of petroleum traffic is likely to be attracted back to the Canal while some 400 million tons would continue to go by the Cape route. This would be a sharp drop from the 175 million tons of oil that passed through the Canal in 1966, when such shipments accounted for 75 percent of traffic. The volume of dry cargo moving via a reopened Suez, however, could easily exceed 100 million tons -- more than half again as much as in 1966. Except for some ore and grain trade, dry cargoes generally move on ships small enough to pass through with full loads. Total traffic through the Canal during its first year thus would probably amount to about two-thirds of its 1966 volume.

3. Sailing distances and times will drop dramatically when ships shift from the Cape to the Canal route, thus lowering freight costs in this trade. Crude oil from the Persian Gulf

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to Rotterdam would move only 6,500 miles compared with 11,300 miles via the Cape. Roundtrip time would drop from 61 days to 38 days for tankers able to transit the Canal loaded, and bigger tankers (up to 150,000 DWT) would be able to make at least one additional voyage per year using the Canal only for return trips. Similar savings would, of course, occur on dry cargo shipments through the Canal.

4. Shipping rates world-wide also will decline because shorter hauls through the Canal will create a shipping surplus estimated at 18 million DWT -- about 4 percent of world capacity. Diversion of tankers up to 50,000 DWT from the Cape route to Suez will make about 4 million DWT redundant, and routing tankers of 51,000-150,000 DWT through the Canal in ballast will free another 6 million DWT. Use of the Canal by dry cargo ships will put almost 8 million DWT of bulk carriers, cargo liners, and container ships on the unemployed list.

5. This glut of shipping will be reflected in an almost immediate drop in both voyage and time charter rates. Owners will scrap some marginal ships and lay up idle tramp and liner vessels too modern to scrap. Both used and new ship prices will fall; buyers of ships in the surplus category may accept penalties to cancel contracts particularly if construction has not yet begun.

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#### Future World Oil Trade

6. Because of the pronounced increase in use of large tankers, the Suez Canal will not resume its pre-1967 role as a vital route for world oil trade. In the last 10 years, the average-sized vessel in the world tanker fleet has increased from 25,000 DWT to 58,000 DWT. The size of the largest tanker in operation has jumped from 130,000 DWT to almost 500,000 DWT. About 70 percent of tanker tonnage currently in use could not move loaded through the Canal at its pre-closure depth of 38 feet (See Table I). Even if Suez were deepened to 60 feet -- a project requiring at least seven years and \$500 million dollars -- it would still not be able to accommodate loaded passage of the growing number of tankers exceeding 200,000 DWT.

7. Tankers small enough to transit the Suez fully loaded (up to 50,000 DWT) have high per unit operating costs. Even now, with bunker fuel prices at three to four times their mid-1973 levels, it would be cheaper to move oil from the Persian Gulf to Rotterdam via the 11,300-mile Cape route on tankers exceeding 100,000 DWT than to use small tankers on the 6,500 mile Suez route. Larger tankers up to 150,000 DWT can cut costs further by using the Canal for the return trip in ballast (see Table II).

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TABLE I  
COMPOSITION OF THE WORLD TANKER FLEET BY SIZE

Size Category in DWT	31 December 1972			31 December 1968			31 December 1963		
	Number	1,000 DWT	Percent of DWT	Number	1,000 DWT	Percent of DWT	Number	1,000 DWT	Percent of DWT
Total	3,728	217,836,200	100.0	3,317	124,324,700	100.0	2,928	74,369,100	100.0
50,000 and under	2,424	62,597,100	28.7	2,559	63,296,400	51.0	2,788	65,335,200	87.0
51,000 to 100,000	753	53,627,000	24.6	636	44,192,600	35.5	136	8,567,400	11.5
101,000 to 150,000	187	22,116,000	10.2	86	9,764,600	7.8	4	466,500	0.6
151,000 to 200,000	78	13,067,100	6.0	17	2,942,600	2.4	--	--	--
201,000 to 300,000	278	63,770,700	29.3	17	3,531,500	2.8	--	--	--
300,000 and larger	8	2,658,300	1.2	2	624,000	0.5	--	--	--

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TABLE II

## BREAKEVEN COSTS -- PERSIAN GULF TO ROTTERDAM

Tanker Size (DWT)	(US \$ Per Ton of Cargo)		
	<u>Via the Cape Roundtrip</u>	<u>Via the Cape Loaded and Via Suez in Ballast*</u>	<u>Via Suez Roundtrip*</u>
350,000	4.82		
250,000	5.43		
150,000	7.15	5.91	
100,000	8.87	7.28	
60,000	11.78	9.60	
50,000	13.24		8.63

*\* Assuming pre-closure toll rates.*

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8. Despite their higher costs, tankers of 100,000 DWT and less remain in the Persian Gulf trade because of limitations on depth at some ports of consignment and on the ability of some terminals and refineries to absorb deliveries. In fact, demand has kept charter rates for such ships at high levels despite today's generally depressed market. For shippers in this portion of the trade, use of 50,000 DWT tankers via Suez will be a particularly attractive option.

9. Over the longer run, oil trade through the Canal also will be affected by completion of the Sumed Pipeline. This line will link a tanker terminal on the Red Sea with one on the Mediterranean, providing another attractive alternative for moving oil from the Persian Gulf to Western Europe and North America. Its southern end will be served by supertankers and its northern end by various-sized tankers, depending on the requirements of the recipient. Once financing for the \$360 million project is arranged and work begun, completion of the first phase will take two years. At that time, the pipeline will have an annual capacity of 40 million tons. A second phase, scheduled for completion during the third year, will raise total capacity to 80 million tons a year. Preliminary estimates indicate that it will cost about 15 percent less to use the pipeline than the Canal.

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The United States

10. The direct economic impact of the reopened Canal on the will be beneficial but small. Shorter hauls from regions east of Suez will reduce the cost of oil and other raw material imports. More important will be the benefits from reduced shipping rates generally, since the US is the world's largest trading nation. The US merchant fleet is small relative to our total trade, and benefits from lower shipping costs thus will be only slightly offset by reduced income from shipping services. Because the US shipbuilding industry serves a protected market, it will be little affected by the drop in world shipping demand and rates.

Western Europe

11. Western Europe will also benefit from reduced shipping costs resulting from the reopening of the Suez Canal. Imports of many raw materials will be cheaper. The net gain for Western Europe will be small, however, because shipbuilding industries will be hurt by the drop in demand for new vessels and some countries such as Norway and Greece will suffer severe losses in shipping income. Shifts in shipping patterns will benefit Mediterranean ports at the expense of those on the European Atlantic.

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## Japan

12. Reduced rates and shorter delivery times will considerably improve Japan's competitive edge in European and distant third markets. This gain will be offset, however, by a drop in shipping income and in shipbuilding orders. Japan's shipbuilding industry accounts for about half of world tanker production. Because it has a huge backlog of orders with delivery dates extending through 1977, the industry probably will continue to operate at capacity for at least this year. New orders already have slipped sharply in response to the oil crisis, however, and contract cancellations are expected.

## USSR

13. Moscow will benefit substantially from a reopened Canal because most Soviet merchant vessels are small enough to transit Suez fully loaded. Since the Canal closed, the USSR has incurred some \$30 to \$50 million annually in additional shipping costs to service its Black Sea trade with India, Iraq, North Vietnam, and other countries east of Suez. In shifting to the much longer Cape route, it has had to divert about 560,000 DWT of shipping from other tasks. Reopening Suez may also provide an alternative route for shipments that now move overland between the Black Sea region and the Soviet Far East.

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14. When the Canal reopens, the USSR will also be able to restore its once sizable exports of petroleum from the Black Sea to India, Japan, and Sri Lanka. Whether it does so will depend on the desirability of continuing swap arrangements made after 1967. Under these deals, Persian Gulf crude controlled by international oil companies has been shipped to Japan on Soviet account and Soviet crude from the Black Sea has moved to the companies' European customers. Because other Warsaw Pact countries are expected to increase imports of Arab oil in the years ahead, they too would benefit from reopening of the Canal.

#### Middle Eastern and African Countries

15. *Egypt* -- If reopened this year at pre-closure toll rates,\* the Canal would earn an estimated \$145 million in foreign exchange in 1975 -- about \$75 million less than 1966 earnings but enough to cut Egypt's prospective balance-of-payments deficit by one-third. The major uncertainty for Egypt is the attitude of wealthy Arab states toward continuing Khartoum

\* *Pre-closure tolls approximated 23 cents per DWT for a ship in ballast and 50 cents per DWT for a loaded ship. Once the Canal is reopened, Egypt could double these rates with little diminution of the Canal's competition advantages.*

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subsidies once the Canal is open. Set up in 1967, the Khartoum agreement provides Egypt approximately \$250 million annually in subsidies until "the effects of the (1967) aggression have been removed" -- a condition generally interpreted to mean until the canal is reopened.\* Libya has already indicated that its \$59 million share will be discontinued, primarily because Qadhafi is opposed to disengagement. If such cuts are not covered by other Arab states, canal revenues will be partly offset by a loss in subsidy payments.

16. Indirect gains are potentially more important to Cairo. By promptly reopening the Canal and announcing a multi-million dollar Canal improvement program, President Sadat would be reassuring the world of Egypt's peaceful intentions. These actions in turn would further stimulate private investors interest, perhaps permitting Egypt to achieve some of its ambitious and long-delayed development goals.

17. Israel -- Israel's use of a reopened Canal would have little impact on its economy. Because internal transport has been improved considerably since 1967, Israel can move supplies to southern ports for export to the East almost as

\* *Ad hoc contributions have provided an even larger financial cushion. For example, during the late 1973 war, wealthy Arab states transferred an estimated \$800 million to Egypt.*

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easily by land as by sea. Moreover, movement of Persian crude through the Elat-Ashkelon pipeline -- supplied by supertanker to Elat and exported to Europe from Askelon -- should continue to be cost-competitive as long as the Canal can accommodate only smaller tankers.

18. *Other Middle East and Africa* -- Countries along the Red Sea and Gulf of Aden will gain from increased bunkering and other port-related activities, regaining some of the earning power lost when the Suez Canal was closed in 1967. Sales of bunkers in Aden, for example, dropped from \$60 million in 1966 to \$6 million in 1968; Djibouti and Port Sudan also suffered severe losses in revenues during this period. Countries or possessions along the Cape route -- Kenya, Mauritius, South Africa, and the Canary Islands, in particular -- will sustain a small decline in their port and bunkering earnings. The reopened Canal will have some favorable impact on the trade of most countries in the region because of reduced shipping, insurance, and storage costs.

#### South Asia

19. The principal countries of South Asia -- India, Pakistan, Bangladesh, and Sri Lanka -- will benefit from substantially reduced freight costs on food and machinery

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imports if the Suez is reopened. Their export earnings also will be boosted moderately. India ships about 45 percent of its exports to Europe, Pakistan and Sri Lanka about 30 percent, and Bangladesh about 40 percent. Their major exports will face stiff competition, however, from other countries also benefiting from the Canal reopening. Tea from India and Sri Lanka, for example, will gain little advantage over East African competitors. Cotton textiles, a principal export of India and Pakistan, will still have to compete with other Asian producers using the Canal. Bangladesh jute exports -- already booming because of decreased competition from petroleum-based synthetics -- and Indian heavy manufactures probably will be the main beneficiaries from the shortened trade route.

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